



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence

Report of the auditor-general to the North West provincial legislature and the council on the Mamusa Local Municipality

Report on the financial statements

Introduction

1. I was engaged to audit the financial statements of the Mamusa Local Municipality set out on pages XX to XX, which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2015 (Act No. 1 of 2015) (DoRA) and for such internal control as the accounting officer determines is necessary to enable the preparation of separate financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with International Standards on Auditing. Because of the matters described in the basis for disclaimer of opinion paragraphs, however, I was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for disclaimer of opinion

Receivables from exchange and non-exchange transactions

4. I was unable to obtain sufficient appropriate audit evidence for receivables from exchange and non-exchange transactions in the current and prior years as the municipality did not have an adequate system of record keeping and internal controls to account for trade and other receivables. In addition, the municipality did not estimate the future cash flows as required by GRAP 104 *Financial instruments* in the calculation of its impairment provision for receivables. It was impracticable to determine the misstatement as a result of this impairment. I was unable to confirm these receivables by alternative means. Consequently, I was unable to determine whether any adjustments relating to receivables from exchange transactions of



R2 454 394 (2015: R18 455 007) or receivables from exchange and non-exchange transactions of R13 223 636 (2015: R9 905 582) as disclosed in notes 8, 9 and 11 respectively, were necessary.

Value Added Tax (VAT)

5. I was unable to obtain sufficient appropriate audit evidence for the VAT receivable and payable due to the differences between the municipality's VAT returns, general ledger and the financial statements. I was unable to confirm the VAT receivable and payable by alternative means. Consequently, I was unable to determine whether any adjustments relating to the VAT receivable of R39 451 418 (2015: R14 271 211) or the VAT payable of R22 951 324 (2015: R16 521 712) disclosed in notes 10 and 20 respectively, were necessary.

Employee benefit obligation

6. I was unable to obtain sufficient appropriate audit evidence for the long service award obligation as the payroll data used by the actuaries to calculate the liability in the current and prior year did not include all employees. In addition, all the disclosures as required by GRAP 25 *Employee benefits* were not made. I was unable to confirm the long service award obligation by alternative means. Consequently, I was unable to determine whether any adjustment relating to the long service award obligation of R2 041 000 (2015: R2 629 000) included in the employee benefit obligation as disclosed in note 16 was necessary.

Accumulated surplus

7. I was unable to obtain sufficient appropriate audit evidence for adjustments made to the accumulated surplus in the current and prior year or for a difference of R13 999 245 (2015: R27 944 848) between the recalculated accumulated surplus disclosed in the statement of net assets and the accumulated surplus reflected in the statement of financial position. I was unable to confirm these adjustments by alternative means. Consequently, I was unable to determine whether any adjustments relating to accumulated surplus of R358 932 415 (2015: R369 655 361) in the financial statements, was necessary.

Revenue

8. I was unable to obtain sufficient appropriate audit evidence for revenue from service charges and property rates as the municipality did not have adequate internal controls to ensure that all service charges and property rate revenue is recognised, actual meter readings billed can be substantiated or that differences on the valuation roll of the prior year were followed up. I was unable to confirm this revenue by alternative means. Consequently, I was unable to determine whether any adjustments relating to revenue from service charges of R54 357 365 (2015: R56 351 632) or revenue from property rates of R11 304 042 (2015: R12 867 781) disclosed in notes 25 and 24 to the financial statements respectively, were necessary.

Employee cost

9. I was unable to obtain sufficient appropriate audit evidence for employee related costs and remuneration of councillors due to unexplained differences between the payroll system, general ledger and the financial statements. I was unable to confirm this expenditure by alternative means. Consequently, I was unable to determine whether any adjustments relating to employee related costs of R52 330 714 (2015: R45 455 484) and remuneration of councillors of R4 739 182 (2015: R4 560 661), as disclosed in the statement of financial performance were necessary.

Statement of comparison of budget and actual amounts

10. The municipality did not adequately disclose the budget information in accordance with GRAP 24 *Presentation of budget information in the financial statements* as no explanations were included in the statement of comparison of budget and actual amounts for the variances between the actual performance and budgeted amounts. In addition, no disclosure was made for the budget and actual amounts in the statement of financial position and the statement of cash flow as required.

Irregular expenditure

11. Section 125 of the MFMA requires the disclosure of irregular expenditure incurred. The municipality made payments of R24 564 424 (2015: R9 647 071) in contravention of the supply chain management requirements that were not included in irregular expenditure disclosed. In addition, I was unable to obtain sufficient appropriate audit evidence to confirm that awards of R10 027 271 (2015: R7 228 993) were made in terms of the supply chain management requirements. The municipality's records did not permit the application of alternative procedures. As the municipality, did not quantify the full extent of the irregular expenditure, it was impracticable to determine the resultant understatement of irregular expenditure disclosed in note 50 to the financial statements.

Unauthorised expenditure

12. Section 125 of the MFMA requires the disclosure of unauthorised expenditure incurred. The municipality made payments of R26 385 533 (2015: R30 535 557) in excess of the approved budget which were not included in unauthorised expenditure disclosed. Consequently, unauthorised expenditure disclosed in note 48 to the financial statements is understated by R26 385 533 (2015: R30 535 557).

Fruitless and wasteful expenditure

13. Section 125 of the MFMA requires the disclosure of fruitless and wasteful expenditure incurred. The municipality paid penalties and interest of R916 729 (2015: 152 434) which were not included in fruitless and wasteful expenditure disclosed. Consequently, fruitless and wasteful expenditure disclosed in note 49 to the financial statements is understated by R916 729 (2015: R152 434).

Cash flow statement

14. I was unable to obtain sufficient appropriate audit evidence for items of R4 172 023 (2015: R33 830 597) included in the cash flow statement due to the cash flow being force balanced. I was unable to confirm these items in the cash flow statement by alternative means. Consequently, I was unable to determine whether any adjustments relating to the cash flow statement or the notes thereto were necessary.

Prior period errors

15. The municipality did not disclose all prior period errors in note 45 to the financial statements as required by GRAP 3 *Accounting policies, estimates and errors*. The nature, the amount of the correction for each financial statement line item affected and the amount of the correction at the beginning of the earliest prior period should be disclosed. I was unable to obtain sufficient appropriate audit evidence regarding the nature of the prior period adjustments made. I was unable to confirm the full extent and the nature of the misstatement by alternative means. Consequently, I was unable to determine whether any adjustments relating to the prior period errors as disclosed in note 45 to the financial statements was necessary.



Material losses

16. The municipality did not correctly calculate and disclose material losses relating to water as required by section 125 of the MFMA. The material losses disclosed in note 51 is overstated by R4 690 024 (381 613 KI).
17. During 2015, I was unable to obtain sufficient appropriate audit evidence for material losses disclosed in note 51 to the financial statements. I was unable to determine whether any adjustments relating to material losses of R5 469 799 as disclosed in note 51 to the financial statements was required. My audit opinion on the financial statements for the period ended 30 June 2015 was modified accordingly. I was still unable to confirm these material losses by alternative means. Consequently, my opinion on the current period's financial statements is also modified because of the possible effect of this matter on the comparability of the current period's figures.

Disclaimer of opinion

18. Because of the significance of the matters described in the basis for disclaimer of opinion paragraphs, I have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, I do not express an opinion on the financial statements.

Emphasis of matter

19. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Restatement of corresponding figures

20. As disclosed in note 45 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of an error discovered during 2016 in the financial statements of the Mamusa Local Municipality at, and for the year ended, 30 June 2015.

Additional matters

21. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Unaudited disclosure notes

22. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion thereon.

Unaudited supplementary schedules

23. The supplementary information set out on pages XX to XX does not form part of the financial statements and is presented as additional information. I have not audited these schedules and accordingly I do not express an opinion thereon.

Report on other legal and regulatory requirements

24. In accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected development priorities presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I



do not express an opinion or conclusion on these matters.

Predetermined objectives

25. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development priorities presented in the annual performance report of the municipality for the year ended 30 June 2016:
- Priority 2: Basic service delivery on pages XX to XX
 - Priority 3: Infrastructure development on pages XX to XX
26. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
27. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned objectives. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for managing programme performance information (FMPPI).
28. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
29. The material findings in respect of the selected objective is as follows:

Priority 2: Basic service delivery

Usefulness of reported performance information

30. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) (MSA) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Important reported indicators and targets were not consistent with those in the approved integrated development plan.
31. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 22% of the indicators were not verifiable.

Reliability of reported performance information

32. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Overall, the reported achievements against planned targets of 29% of the reported indicators were not reliable when compared to the source information or evidence provided. In addition, adequate and reliable corroborating evidence could not be provided for the reported achievements against planned targets of significantly important indicators.

Priority 3: Infrastructure development

Usefulness of reported performance information

33. Section 41(c) of the MSA requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. Important reported indicators and 27% of the reported targets were not consistent with those in the approved integrated development plan.
34. Performance indicators should be well defined by having clear definitions so that data can be



collected consistently and is easy to understand and use and the processes and systems that produced the indicator should be verifiable, as required by the FMPPI.

- A total of 26% of the indicators were not well defined.
- A total of 30% of the indicators or were not verifiable.

Reliability of reported performance information

35. The FMPPI requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly 47% important targets were not reliable when compared to the source information or evidence provided.

Additional matter

36. I draw attention to the following matter:

Achievement of planned targets

37. Refer to the annual performance report on pages XX to XX and XX to XX for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the usefulness and reliability of the reported performance information for the selected development priorities reported in paragraphs XX to XX of this report.

Compliance with legislation

38. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Annual financial statements and annual report

39. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements identified by the auditors in the submitted financial statements were not subsequently corrected and the supporting records could not be provided subsequently. The uncorrected material misstatements and supporting records that could not be provided resulted in the financial statements receiving a disclaimer audit opinion.
40. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.
41. The oversight report was not adopted by the council on the 2014-15 annual report, thus also not made public, as required by section 129(3) of the MFMA.

Budgets

42. Expenditure was incurred that was in excess of the approved budget, in contravention of section 87(8) of the MFMA.

Consequence management

- 43. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
- 44. Fruitless and wasteful expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(b) of the MFMA.
- 45. Unauthorised expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a) of the MFMA.

Expenditure management

- 46. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
- 47. Reasonable steps were not taken to prevent unauthorised expenditure, irregular expenditure and fruitless and wasteful expenditure as required by section 62(1)(d) of the MFMA.

Revenue management

- 48. An effective system of internal control for debtors and revenue was not in place, as required by section 64(2)(f) of the MFMA.

Human resources management

- 49. The competencies of the financial and supply chain officials were not assessed in a timely manner in order to identify and address gaps in competency levels as required by regulation 13 of the Municipal Regulations on Minimum Competency Levels.
- 50. The municipality did not develop and adopt appropriate systems, policies and procedures to monitor, measure and evaluate performance of staff in contravention of section 67(d) of MSA.

Procurement and contract management

- 51. We could not obtain sufficient appropriate audit evidence that all contracts and quotations were awarded in accordance with the legislative requirements and a procurement process which is fair, equitable, transparent and competitive, as the municipality did not keep proper records.
- 52. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations, in contravention of SCM regulations 17(a) and (c).
- 53. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
- 54. I could not obtain sufficient appropriate audit evidence that bid specifications were unbiased and allowed all potential suppliers to offer their goods or services, as required by SCM regulation 27(2)(a).
- 55. Bids were not always evaluated by bid evaluation committees which were composed of officials from the departments requiring the goods or services and at least one SCM practitioner of the municipality, as required by SCM regulation 28(2).
- 56. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM regulations 21(b) and 28(1)(a) and the Preferential Procurement Regulations.

57. Bid adjudication committees were not always composed in accordance with SCM regulation 29(2).
58. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act and SCM regulation 28(1)(a).
59. Contracts were awarded to bidders based on preference points that were not allocated and calculated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
60. Contracts were awarded to bidders that did not score the highest points in the evaluation process, in contravention of section 2(1)(f) of the Preferential Procurement Policy Framework Act.
61. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
62. Construction contracts were awarded to contractors that did not qualify for the contract, in contravention of section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
63. I could not obtain sufficient appropriate audit evidence that contracts were only extended or modified after tabling the reasons for the proposed amendment in the council of the municipality, as required by section 116(3) of the MFMA.
64. I could not obtain sufficient appropriate audit evidence that all extensions or modifications to contracts were approved by a properly delegated official, as required by SCM regulation 5.
65. I could not obtain sufficient appropriate audit evidence to conclude whether the performance of contractors or providers was monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
66. I could not obtain sufficient appropriate audit evidence to conclude whether the contract performance and monitoring measures and methods were sufficient to ensure effective contract management, in contravention of section 116(2)(c) of the MFMA.
67. Awards were made to providers who were in the service of other state institutions, in contravention of section 112(j) of the MFMA and SCM regulation 44. Similar awards were identified in the previous year and no effective steps were taken to prevent or combat the abuse of the SCM process, as required by SCM regulation 38(1).
68. Persons in service of the municipality whose close family members had a private or business interest in contracts awarded by the municipality failed to disclose such interest, in contravention with SCM regulation 46(2)(e).
69. SCM officials / other SCM role players whose close family members/ partners/ associates had a private or business interest in contracts awarded by the municipality participated in the process relating to that contract, in contravention of SCM regulation 46(2)(f).
70. Contracts were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, in contravention of SCM regulation 43.

Strategic planning and performance management

71. The KPIs set by the municipality did not include indicators on percentage of households with access to basic level of water and sanitation as required by section 43(2) of the MSA and regulation 10(a) of the Municipal planning and performance management regulations.
72. The service delivery and budget implementation plan (SDBIP) for implementing the municipality's delivery of municipal services and annual budget did not indicate the operational and capital expenditure by vote as required by section 1 and 53(1)(c) of the MFMA.

Environmental management

- 73. The municipality did not exercise its legislative and executive authority as required by section 11(3)(l) and (m) of the MSA by managing, monitoring and enforcing environmental related bylaws to promote a safe and healthy environment.
- 74. The municipality's waste management and disposal activities contravened or failed to comply with the requirements of section 28(1) of the NEMA, section 19 of the NWA and sections 16(1)(c) and (d) and 26(1)(b) of the NEMWA.

Internal control

- 75. I considered internal control relevant to my audit of the financial statements, the annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the basis for qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

- 76. Leadership did not sufficiently exercise their oversight responsibility regarding financial and performance reporting, compliance with legislation and the related internal controls to prevent material misstatements to the financial statements. This resulted in audit findings from the previous years being repeated.
- 77. Leadership did not review the annual performance plan in sufficient detail to ensure that the key performance indicators were worded in such a manner that a system of internal control could be designed to collect valid and accurate source documents on a consistent basis throughout the reporting period.

Financial and performance management

- 78. Management did not put adequate processes in place to ensure that the internal review procedures could identify and correct material misstatements in the financial statements before these were submitted for auditing.

Governance

79. Management did not implement appropriate risk management activities specifically tailor made for the municipality to ensure that regular risk assessments, including consideration of IT risks and fraud prevention, were approved and that a risk strategy to address these risks were developed and monitored. Management had limited interaction with the audit committee causing the recommendations made by the audit committee not to be implemented by council.

Potchefstroom

30 November 2016



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